

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:  
, ID No.

Telephone Number:

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August 17, 2020

LEGEND

X =

Y =

Z =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Dear \_\_\_\_\_ :

This responds to a letter dated January 16, 2020, submitted on behalf of X by X's authorized representative, requesting a ruling under §1362(f) of the Internal Revenue Code (the Code).

#### FACTS

The information submitted states that Y was incorporated under the laws of State on Date1. Y elected to be taxed as an S corporation effective on Date2. X was formed by Y as its wholly-owned subsidiary under the laws of State on Date3. Y made an election under § 1361(b)(3)(B)(ii) to treat X as a Qualified Subchapter S Subsidiary ("QSub") effective on Date3. On Date4, Trust1 acquired shares of Y. On Date5, Trust2 and Trust3 acquired shares in Y. On Date6, Trust4 acquired shares in Y.

On Date7, incident to what X represents was part of a reorganization under § 368(a)(1)(F), Y merged with X and the Y shares were replaced with X shares, and X was treated as the surviving corporation. On Date8, X entered into an agreement to be acquired by Z.

X represents that timely and proper Electing Small Business Trust (ESBT) elections under § 1361(e) were never made on behalf of Trust1, Trust2, Trust3 and Trust4 (the “trusts”).

X represents that the trusts meet the requirements of § 1361(e)(1)(A) to be ESBTs, except that ESBT elections were not timely made on behalf of each of the trusts at the time the stock was transferred to the trusts, respectively. Accordingly, the S corporation election of X terminated on Date4, the date that stock was first acquired by Trust1, because Trust1 was an ineligible S corporation shareholder at the time of that transfer. In addition, the S corporation election of X would have terminated on subsequent dates as a result of the transfers of stock to Trust2, Trust3, and Trust4, if the election had not already terminated on Date4.

X represents that X and all of its shareholders have always filed tax returns consistent with X being an S corporation. In addition, X represents that each of the trusts have filed tax returns consistent with their treatment as ESBTs. X further represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make adjustments consistent with the treatment of X as an S corporation, and the trusts as ESBTs, as may be required by the Secretary.

#### LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e)(1)(A) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that an ESBT does not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2) provides that (A) an election under subsection (a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation; and (B) any termination under this paragraph shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by a corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date4 as the result of the failure of the trustee of Trust1 to make an election under § 1361(e)(3) to treat Trust1 as an ESBT effective as of the date of the transfer of Y stock to Trust1. In addition, Y's S corporation election would have terminated on Date6 when Y stock was transferred to Trust2 and Trust3, or on Date7 when Y stock was transferred to Trust4, as a result of the failure of the trustees of Trust2, Trust3 and Trust4 to make timely and proper ESBT elections under § 1361(e)(3) on behalf of those trusts, if Y's S corporation election had not previously terminated on Date4. We further conclude that the termination of Y's S corporation election on Date4, or potentially thereafter, was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date4 and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d) for reasons not addressed in this letter. Finally, the election by Y to treat X as a QSub of Y remains valid and effective for the period from Date4 to Date7.

This ruling is contingent on the trustees of Trust1, Trust2, Trust3 and Trust4 filing ESBT elections on behalf of their respective trusts, with effective dates of Date4, Date5, Date5 and Date6, respectively, with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to each election.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding Y' or X's eligibility to be an S corporation. In addition, no opinion is expressed as to whether Trust1, Trust2, Trust3 and Trust4 are eligible to elect to be treated as ESBTs.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification upon examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending copies of this letter to X's authorized representatives.

Sincerely,

Adrienne M. Mikolashek  
Branch Chief, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: